

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GALLINAS VILLAGE, INC.)

Appearances:

For Appellant: James S. Cappis, Certified Public
 Accountant

For Respondent: A. Ben Jacobson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Gallinas Village, Inc., for refund of franchise tax in the amount of \$600.32 for the taxable year 1954.

Appellant was incorporated and commenced business in California on January 16, 1953. Its capital stock was owned equally by two companies, one of which was J. D. O'Connor Construction Co., Inc. Appellant adopted a calendar year and reported its income on the accrual basis. Its entire income was derived from the sale, in 1953, of a parcel of land to Norcal Excavating and Construction Co., Inc., an affiliate of the O'Connor corporation, and from interest on the unpaid balance of the selling price. Under the terms of sale, Norcal was to pay for the land as it improved and disposed of each lot and was to pay interest on the unpaid balance from the date of the sale to the date of payment.

In December, 1954, the stockholders decided to liquidate Appellant. On January 14, 1955, prior to the completion of the liquidation, Appellant received a payment of \$50,515.57 from Norcal. Of this amount, Appellant credited \$41,462.09 to principal and \$9,053.48 to accrued interest, computed to June, 1955. The application of this payment was later revised to reflect accrual of interest only to December 15, 1954, resulting in the elimination of \$796.83 in the amount of interest payable by Norcal.

Since Appellant's first taxable year was a period of less than 12 months, it was required to and did prepay a tax for its second taxable year, ended December 31, 1954, based on the income of its first year (see Section 23222 of

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the Revenue and Taxation Code). Appellant had no net income in its second taxable year.

Appellant contends that it did business for less than 12 months in its second taxable year and that, therefore, under Section 23222a of the Revenue and Taxation Code, the tax for the second taxable year should be based on the income for that year. The Franchise Tax Board contends that Appellant did business for the entire year, of 1954 and that, under Section 23222 of the Code, the tax may not be less than the prepayment for that year.

Doing business is defined by Section 23101 of the Code as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. The Franchise Tax Board alleges and Appellant does not deny that the holding and collection of interest-bearing notes constitute doing business as so defined. Appellant alleges, however, that its stockholders agreed in their liquidation plan in December of 1954, not to charge interest on the Norcal receivable after December 15, 1954. The only evidence in support of this allegation is the following affidavit:

"Carl L. Davis, being first duly sworn, says that he was Treasurer of Gallinas Village Company, Inc. (hereinafter referred to as Gallinas), a dissolved corporation, that Gallinas owned as an asset an interest bearing account receivable from Norcal Excavating and Construction Co., Inc. (hereinafter referred to as Norcal); that during the latter part of the year 1954 and before December 15th, the shareholders of Gallinas elected to dissolve Gallinas and adopted a plan of dissolution; that pursuant to such plan of dissolution interest was not to be thereafter accrued on the Norcal receivable; that on August 17, 1955 affiant sent a letter addressed to Herbert F. Baker, accountant for J. D. O'Connor Construction Co., Inc. which owned 50% of the outstanding capital stock of Gallinas wherein interest was charged on the Norcal receivable after December 15, 1954; that thereafter affiant's attention was drawn to the prior arrangement regarding interest on the receivable from Norcal; that

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affiant thereafter re-computed the balance due from Norcal and eliminated the interest previously accrued after December 15, 1954."

The Franchise Tax Board questions whether there was a definite agreement prior to the end of 1954 not to charge interest to Norcal after December 15 of that year,

We have concluded that the facts stated in the affidavit fail to establish that interest was not accruable after December 15, 1954. A mere plan by the Appellant and its stockholders not to charge interest did not relieve Norcal of its legal liability to pay the interest due (see Sections 1541 and 1698 of the Civil Code). In our opinion Appellant during the entire year 1954 retained the right to the interest and properly accrued it in that year (Spring City Foundry v. Commissioner, 292 U.S. 182; The Parsch Realty Co., T.C. Memo. Dec., Dkt, No. 44833, entered August 26, 1954).

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Gallinas Village, Inc., for refund of franchise tax in the amount of \$600.32 for the taxable year 1954 be and the same is hereby sustained,

Done at Sacramento, California, this 23rd day of July, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman

George R. Reilly, Member

Alan Cranston, Member

John W. Lynch, Member

Richard Nevins, Member

ATTEST: Dixwell L. Pierce, Secretary